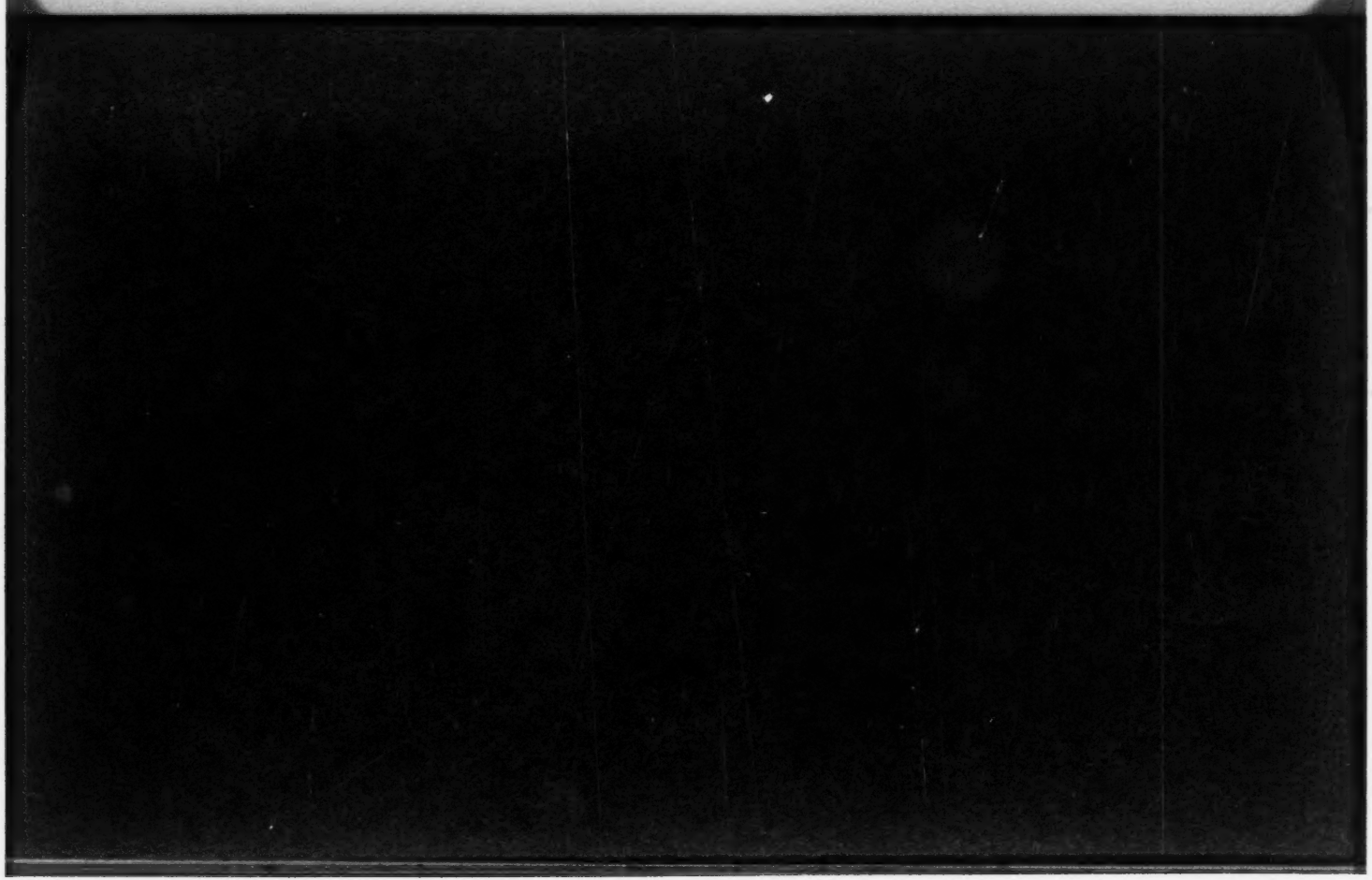

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502456—42

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 560

CHARLES T. KLINE, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 193a–199a) is reported at 44 B. T. A. 1052. The opinion of the Circuit Court of Appeals (R. 203–208) is reported at 130 F. 2d 742.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered September 1, 1942 (R. 209). Petition for a writ of certiorari was filed December 1, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, in the circumstances of this case, there was reasonable ground for approving the Commissioner's determination of value of certain restricted stock for gift tax purposes under Section 506 of the Revenue Act of 1932.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 501. IMPOSITION OF TAX.
>
> (a) For the calendar year 1932 and each calendar year thereafter a tax, computed as provided in section 502, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift.
>
> * * * * *
>
> SEC. 506. GIFTS MADE IN PROPERTY.
>
> If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

Treasury Regulations 79 (1936 Ed.):

> ART. 17. *Gifts made in property.*—A gift made in property is subject to the tax in the same manner as a gift of cash, and the amount of the gift is the value of the property at the date of the gift.
>
> ART. 19. *Valuation of property.*—* * *
>
> * * * * *
>
> (3) *Stocks and bonds.*—* * *
>
> If the value of a security cannot be determined by sales, or from bid and asked prices, as prescribed in the preceding pro-

> visions of this subdivision, then, * * * in the case of shares of stock, upon the basis of the company's net worth, earning power, dividend-paying capacity, and all other relevant factors having a bearing upon the value of the stock. * * *
>
> * * * * * *

STATEMENT

The sole issue in this case involves the valuation, for gift tax purposes, of certain securities transferred in trust by the petitioner on December 24, 1937.

Petitioner, a resident of Merion, Pennsylvania, on December 24, 1937, executed an irrevocable trust, declaring that he had caused to be transferred to his name as trustee 4,500 common shares of E. J. Lavino & Company, "being Voting Trust Certificate No. 11, issued under the terms of a certain Voting Trust Agreement dated January 4, 1930." As trustee, he was to collect the dividends, pay charges incident to management, and pay the net income for his life to his wife, Ellen S. Kline. After his death, interest and principal were to be paid to his wife, son, or the son's descendants. (R. 193a.)

Petitioner became an employee of E. J. Lavino & Company in 1919, and has been a director and executive vice president since 1927. On November 22, 1928, the company distributed 3,000 shares of its common stock, pursuant to directors' resolution authorizing the president and the chairman of the board of directors "to donate and transfer"

certain shares then held in the treasury to "such of the officers or employees of the corporation as they may determine, * * * subject, however, to such conditions, restrictions and agreements as they shall in their discretion impose and make * * *." The conditions and restrictions were embodied in a written instrument which each distributee signed, agreeing not to sell his shares without the company's consent as long as he should remain in its employ, and in the event of death or the severance of his connection with the company, to offer his stock to the company (R. 193a–194a)—

> * * * at a price not to exceed seventy-five percent (75%) of its book value as shown on the Company's statement at the date of the last previous closing of its books for a period of one year from the date of his death or of such severance of connection with the Company, during which period the Company shall have the option to purchase all or any part of such stock, * * *

In the event that the employee should sever his connection with the company "under conditions not acceptable to its Board of Directors or with which the said Board is not in sympathy", he was to offer his stock to the company on the above terms "at a price not to exceed fifty percent. (50%) of its book value", and in the event that he should be discharged for cause, "at a price not to exceed thirty-three and one-third percent. (33⅓%) of its book value." The agreement

was made binding on his executors, administrators, and successors. All share certificates issued to the employees bore this endorsement (R. 194a):

> This certificate and the shares of stock represented thereby are transferable only upon compliance with the covenants and conditions set forth in an agreement in writing between the stockholder and the Company dated November 22, 1928.

Of the 3,000 shares so distributed in 1928, petitioner received 700. On October 22, 1929, the company distributed 10,300 more shares on the same conditions; petitioner received 3,800. After an amendment of its charter the company recalled its old share certificates and issued new ones in place thereof, and on January 4, 1930, petitioner received a certificate for 4,500 new shares of common stock, subject to the same restriction agreement. On the same date, holders of 45,200 of the 50,000 issued common shares executed an agreement with Edward J. and Edwin M. Lavino, as trustees, whereby certificates for the common shares, endorsed in blank, were transferred to the trustees with full voting rights, and the trustees issued to each depositor a "Common Stock Trust Certificate" for the number of shares deposited by him, entitling him to receive that number on termination of the trust at the end of ten years (or earlier in the trustees' discretion), and meanwhile to receive payments equal to the dividends collected by the trustees on that number

of shares. The certificates were transferable, but bound "each successive holder hereof to all the terms and provisions of [the trust] agreement the same as if such holder were a party thereto." The trustees surrendered all deposited certificates to the company and received a single new certificate for 45,200 common shares. Of the deposited shares, 25,500 were not subject to the restriction agreement; the remainder were subject to it. (R. 194a–195a.)

Petitioner deposited his certificate for 4,500 common shares, and received a common stock trust certificate for a like number. He endorsed this in blank and delivered it to the trustees on December 24, 1937, and on the same date they issued to him, as trustee, common stock trust certificate No. 11, of which he declared himself trustee by the trust instrument of the same date, above described. On December 1, 1937, the company's directors (R. 195a)—

> RESOLVED that there would be no objection on the part of the Corporation to the transfer of common stock registered in the name of Charles T. Kline, subject to restriction agreement, to Charles T. Kline, Trustee, for the benefit of Ellen S. Kline, the said stock after transfer to still be subject to the restriction agreement heretofore obtaining.

On December 24, 1937, petitioner was 59 years of age and had a life expectancy of 14.1 years. His services as a director and executive vice presi-

dent of the company were satisfactory to its officers and directors, and he has since continued in those capacities. (R. 195a.)

The company's books showed a surplus of $1,158,794.63 on December 31, 1936, and of $1,753,779.89 on December 31, 1937. On both dates its capital stock account carried a credit of $500,000 on account of the 50,000 shares of common stock; $142,679.86 was carried as a reserve for doubtful accounts. The company is successfully engaged in the business of shipping, importing ores, and manufacturing refractories. Its earnings and dividends for two years prior and two years subsequent were as follows (R. 196a):

Year	Gross Income	Net Income	Preferred dividends paid	Available for common dividends	Dividends per common share	Common dividends paid
1936	$7,318,238.28	$569,151.26	$141,281.25	$427,870.00	$4.00	$200,000.00
1937	8,403,870.99	838,443.92	42,812.50	795,631.42	4.00	200,000.00
1938	6,747,467.71	229,034.80	42,812.50	186,222.30	.75	37,500.00
1939	7,558,900.57	812,231.70	42,812.50	769,419.20	4.00	200,000.00

The Board sustained the Commissioner's valuation of $43 per share (R. 199a). The court below affirmed (R. 209).

ARGUMENT

In view of the expanding business of the company in an established field, a large and sound capitalization, an increasing surplus, and current earnings which were considerably more than necessary to pay dividends of $4 per share, the stock undoubtedly had a very substantial value for gift tax purposes. The voting trust did not of itself

impair that value. Where the purpose was, as here, to insure continuity of management and to prevent internal friction, the usual consequence of such a voting trust is to enhance the value. Thus, the only depressing factor is the restrictive agreement under which the company had the option to repurchase the stock under specified conditions. In analyzing the real effect of such a factor, the Board and the court below properly considered the probability of its use in the light of circumstances as they here appear; and in approving the Commissioner's finding of $43 per share the Board noted that this figure reflected a substantial allowance for the adverse effect of the restriction, since the value would otherwise have been considerably higher. This is a reasonable and a practical solution to a troublesome factual question and the decision presents no ground for the issuance of the writ.

1. The decision below does not conflict with *Helvering* v. *Tex-Penn Co.*, 300 U. S. 481. In the *Tex-Penn* case this Court stated, as an alternative ground for its decision, that profit realized upon a certain exchange was not taxable because the securities received in exchange did not have a fair market value capable of being ascertained with reasonable certainty when viewed in the light of their highly speculative quality and in the light of a restrictive agreement. (P. 499.) It is exceedingly dubious whether the Court would have reached that conclusion upon the basis of the restrictive agreement alone. Indeed, in *Whitney Corporation* v. *Commis-*

sioner, 105 F. 2d 438, 441 (C. C. A. 8th), the court specifically stated that it understood that branch of the *Tex-Penn* decision to rest primarily upon the highly speculative character of the securities. No such facts are present here. See also *Heiner* v. *Gwinner,* 114 F. 2d 723 (C. C. A. 3d), certiorari denied, 311 U. S. 714.

2. Probable conflict with *Helvering* v. *Salvage,* 297 U. S. 106, is also asserted. (Pet. Br. 10.) There the restriction was specific as to time and amount and was between parties who might be expected to press their bargaining advantages. *Propper* v. *Commissioner,* 89 F. 2d 617 (C. C. A. 2d), and *Lomb* v. *Sugden,* 82 F. 2d 166 (C. C. A. 2d), likewise relied upon (Pet. Br. 15–16), are similarly distinguishable. In the case at bar, the Board and the court below both concluded that it was highly improbable that the option in the restriction agreement would ever be exercised and, if so, only at the higher basis. In such a case, it is appropriate to consider the practical effect of the restriction and the probability of its use. *Newman* v. *Commissioner,* 40 F. 2d 225 (C. C. A. 10th), rehearing denied, 41 F. 2d 743, certiorari denied, 282 U. S. 858.

3. The failure to place full reliance upon the opinion testimony of the petitioner's witnesses as to the value of the stock furnishes no ground for certiorari. The cases cited (Pet. Br. 16) turn upon their own facts. See in this connection *Uncasville Mfg. Co.* v. *Commissioner,* 55 F.

2d 893 (C. C. A. 2d), certiorari denied, 286 U. S. 545, in which the court expressly indicated that *Bonwit Teller & Co.* v. *Commissioner,* 53 F. 2d 381 (C. C. A. 2d), did not lay down the general rule here attributed to it by the petitioner. (Br. 17.) In a valuation case where other evidence is submitted, opinion testimony is only one factor to be considered. *Dayton P. & L. Co.* v. *Comm'n.,* 292 U. S. 209, 299; *Rogers* v. *Helvering,* 107 F. 2d 394 (C. C. A. 2d). It seems clear from the respective opinions that both the Board and the court below here reached a correct conclusion based upon a reasonable evaluation of all the pertinent factors.

4. The decision below is not arbitrary and capricious, as the petitioner asserts. (Br. 20.) The case can not be argued as if the most drastic of the eventualities had occurred. Nothing had happened at the time of the gift to invoke any one of the contingent options.[1] If reasonable weight

[1] In the circumstances here presented (R. 198a), it was highly improbable that any option would have been exercised by the company. Perhaps the most likely eventuality was that the petitioner would die or resign under favorable circumstances, thus giving rise to the option of the company to purchase the stock at seventy-five percent of the book value as of the last closing of its books. The taxable transaction took place on December 24, 1937. It was not likely that this eventuality would occur in the few intervening days prior to the closing of the books on December 31, 1937. Hence, to test the Commissioner's determination, it is reasonable to look to the book value as of that date rather than a year back, December 31, 1936, as the petitioner insists. The Board

is given to the improbability of the exercise of the option at either of the two lower levels, at least in the immediate future, and to the permanent and expanding nature of the business, there is ample justification for the determination of $43 per share, giving full consideration to the restriction in the light of the unique circumstances here disclosed. In the two years immediately following the gift, the company's surplus account increased approximately fifty percent (R. 41a). In 1937, the year in which the gift was made, the company earned approximately $16 per share on the outstanding 50,000 shares of common stock (R. 44a, 73a). In the years 1936 through 1939, the company's net income was the approximate equivalent of $49 per share (R. 44a, 73a). Without the restriction, the value might well have been set at a figure far in excess of $43 per share. There is no basis for the petitioner's assertion (Br. 20) that the decision approving a valuation of $43 per share was arbitrary and capricious and that it attached no material weight to the restriction agreement.

---

found that (R. 195a) as of December 31, 1937, the company's books showed a surplus of $1,753,779.89, a capital stock credit of $500,000 on account of the 50,000 shares outstanding, plus a reserve for doubtful accounts of $142,679.86. Seventy-five percent of this aggregate book value would exceed $36 for each of the 50,000 shares. The valuation of $43 per share is thus approximated even if it be assumed that the condition would arise and that the company would exercise the option on the petitioner's death or resignation. When further allowance is made because of the likelihood that even to this extent the option would never be exercised by the company, then the figure of $43 as the true value can not be said to be excessive.

CONCLUSION

The Board correctly applied and the court below approved recognized principles of valuation to the unique facts of this case. There is no conflict. The petition should be denied.

Respectfully submitted.

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